DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

July 30, 2002

Number: **200246002**
Release Date: 11/15/2002

CC:PA:CBS:Br2
GL-676493-95

UILC: 09.13.00-00
09.13.01-00
09.13.03-00
09.18.00-00
09.26.00-00
09.26.06-00
9999.98-00

MEMORANDUM FOR ASSOCIATE AREA COUNSEL, SB/SE:2 (WASHINGTON, D.C.)

FROM: Michael Gompertz
Senior Technician Reviewer, Branch 2 (Collection, Bankruptcy & Summonses)

SUBJECT: Retention of Tax Lien after Chapter 13 Bankruptcy Proceeding

This memorandum responds to your request for advice in connection with the issue set forth below. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent. This writing may contain privileged information.

LEGEND:

Date 1 =
Date 2 =
Date 3 =
Date 4 =
Year =
Dollar Amount 1 =

ISSUE:

Whether a federal tax lien on the Chapter 13 debtors' interests in certain retirement plans may be stripped if the debtors' interests in the plans were not property of the estate and the Service's allowed secured claim, which was provided for by the Chapter 13 plan, did not include the value of the debtors' interests in the retirement plans.

CONCLUSION:

We conclude that the federal tax lien was not stripped in this case. Although lien stripping may be permitted in Chapter 13 cases with respect to property of the estate (see B.C. § 541) or property in which the estate has an interest (see B.C. § 506), the debtors' interests in the retirement plans at issue in the present case were at no time property of the estate or property in which the estate had an interest. Further, the Service's secured claim in the present case did not include the value of the debtors' interests in the non-estate retirement plans. We therefore conclude that the Service's lien was not stripped from the debtors' interests in the retirement plans. Although the Chapter 13 plan did provide for payment of the Service's secured claim insofar as it was secured by assets of the estate and all required plan payments were made to the Service, this does not justify lien stripping with respect to the tax lien on the debtors' interests in the retirement plans.

BACKGROUND:

The Service filed a Notice of Federal Tax Lien against the debtors on Date 1. Thereafter, on Date 2, the debtors filed a Chapter 13 bankruptcy petition. In connection with this Chapter 13 bankruptcy, the Service filed a timely proof of claim but determined it could not claim secured status in the bankruptcy proceeding as to the value of the debtors' interests in the retirement plans, which were not property of the estate. We note that although it is currently the Service's position, pursuant to In re Lyons, 148 B.R. 88 (Bankr. D.D.C. 1992), that the value of a debtor's interests in such retirement plans is estate property with respect to the Service and thus may be included by the Service in calculating its secured claim in the bankruptcy proceeding, this was not the position of the Service at the time of the proceeding in the present case. In connection with the Chapter 13 proceeding, the debtors filed a complaint commencing an adversary proceeding to determine the validity of the tax lien against the debtors' interests in the retirement plans. In an Order filed on Date 3, the bankruptcy court "concluded that under applicable law, Debtors' retirement and savings accounts are not property of their Estate" and dismissed the complaint for lack of subject matter jurisdiction over the dispute regarding the validity of the tax lien against non-estate property. The debtors' appeal of this decision was voluntarily dismissed. The Service's secured claim of approximately $Dollar Amount 1 was paid under the plan. The remainder of the Service's claim was unsecured. The debtors received a discharge from bankruptcy in Date 4.

Soon after the discharge, the Service determined that its pre-petition tax lien survived with respect to the debtors' interests in the retirement plans, which were never part of the bankruptcy estate. Based upon the survival of its tax lien with respect to the non-estate property, the Service levied upon the retirement plans in Year. These levies were not honored. The Service has recently levied upon the retirement plans again.

LAW & ANALYSIS:

1. Lien Stripping in General

Pursuant to I.R.C. § 6325(a)(1), a tax lien shall be released when the tax liability "has been fully satisfied or has become legally unenforceable." However, in the context of a bankruptcy discharge of the underlying tax liability, this statute has been interpreted as not requiring the Service "to release valid tax liens when the underlying tax debt is discharged in bankruptcy." Isom v. United States (In re Isom), 901 F.2d 744, 745 (9th Cir. 1990). Thus, the fact that the debtors in the present case were relieved of the underlying tax liabilities pursuant to the bankruptcy discharge does not, by itself, indicate that the Service's tax lien did not survive bankruptcy. To the contrary, the general rule is that a tax lien is not extinguished by a bankruptcy discharge. See United States v. Alfano, 34 F. Supp. 2d 827 (E.D.N.Y. 1999).

Notwithstanding the general rule preserving the tax lien despite the bankruptcy discharge when the full tax liability has not been satisfied, certain provisions of the Bankruptcy Code may operate to strip the lien. For example, B.C. § 506(a) provides that "[a]n allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property . . . and is an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim." Section 506(d) then adds that "[t]o the extent that a lien secures a claim against the Debtor that is not an allowed secured claim, such lien is void." These provisions, read together, appear to permit a debtor to bifurcate the lien into secured and unsecured portions, and then to void the unsecured portion of the lien. This process is often referred to as "lien stripping."

Although § 506(d) appears to expressly permit lien stripping in bankruptcy, the Supreme Court, in Dewsnup v. Timm, 502 U.S. 410 (1992), ruled in a Chapter 7 case that an "allowed secured claim" as referenced in section 506(d) does not have the same meaning as a secured claim pursuant to section 506(a) and therefore section 506(d) may not be used to void undersecured liens in a Chapter 7 bankruptcy case. See id. at 417. The scope of the decision appeared to be limited to Chapter 7 cases. See id. Nevertheless, because section 506 is part of Chapter 5 of the Bankruptcy Code and Chapter 5 provisions are generally applicable to Chapter 13 cases pursuant to section 103 of the Bankruptcy Code, a strong argument can be made that the interpretation of section 506(d) in Dewsnup applies in Chapter 13 proceedings. Even if the Dewsnup interpretation of section 506(d) precludes the use of that section as a basis for lien stripping in Chapter 13 cases, other sections in Chapter 13 may operate to permit lien stripping.

For example, section 1322(b)(2) allows the Chapter 13 plan to "modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence." The Supreme Court examined the scope of this provision in Nobleman v. American Sav. Bank, 508 U.S. 324 (1993) where it generally held that the exception in section 1322(b)(2) prohibited the Chapter 13 plan from modifying the rights of the mortgagee creditor.[1] In its opinion, the Court acknowledged that based on applicable state law one of the creditor rights protected by the exception was "the right to retain the lien until the debt is paid off." Id. at 329. Thus, although the case turned on the exception of section 1322(b)(2), by acknowledging that the exception protected the secured creditor's right to retain its lien until the debt is paid off, Nobleman implied that section 1322(b)(2) may permit a Chapter 13 plan to modify a secured creditor's right to retain its lien. Id.; see Bank One, Chicago v. Flowers, 183 B.R. 509, 517 (N.D. Ill. 1995); see also In re Cooke, 169 B.R. 662, 666 (Bankr. W.D. Mo. 1994).

Nonetheless, a Chapter 13 plan's ability to modify the secured creditor's right to retain its lien may be limited pursuant to section 1325(a)(5), which deals with a plan's treatment of secured claims and must be complied with in order to assure confirmation of the plan. More precisely, section 1325(a)(5) limits a plan's ability to modify rights of secured creditors by requiring "with respect to each allowed secured claim provided for by the plan," that, unless the creditor agrees otherwise or the debtor surrenders the property to the creditor, the plan must provide "that the holder of such claim retain the lien securing such claim." However, this provision has been interpreted to require "that Chapter 13 creditors retain an enforceable lien on the 'allowed secured claim,' as described by 506(a). . . . As such, § 1325(a) appears to mandate the confirmation of payment plans that contain 'strip down' provisions, provided that such payment plans satisfy all other § 1325 conditions." Bank One, Chicago v. Flowers, 183 B.R. 509, 517 (N.D. Ill. 1995); see also In re Townsend, 256 B.R. 881, 884 (Bankr. N.D. Ill. 2001).

In addition, section 1327, dealing with the effect of the confirmation of a plan, provides further support for lien stripping. Unless the Chapter 13 plan provides otherwise, section 1327(c) mandates that the property of the estate, which vests in the debtor upon confirmation of the plan, "is free and clear of any claim or interest of any creditor provided for by the plan." Coupled with the language of the Chapter 13 provisions discussed above, this provision appears to permit lien stripping upon confirmation of the Chapter 13 plan. See In re Hernandez, 175 B.R. 962, 967 (N.D. Ill. 1994). Thus, based on the above referenced provisions, "lien stripping" may be permitted in Chapter

---

[1]We note that B.C. § 1322(c)(2), enacted after Nobleman, limits this general protection of mortgagee creditors with respect to home mortgages where the final payment is due before the final Chapter 13 plan payment is due. See In re Young, 199 B.R. 643 (Bankr. E.D. Tenn. 1996).

13 bankruptcy cases even if Dewsnup is interpreted as prohibiting the use of § 506(d) to strip the liens of undersecured creditors.

2. Application of Lien Stripping Principles to the Facts Presented

While we acknowledge that "lien stripping" may be permitted under Chapter 13, we believe that the Service's lien in this case on non-estate property survived the Chapter 13 bankruptcy proceeding. In support of our view, we repeat the general rule that a tax lien is not extinguished by a bankruptcy discharge. See United States v. Alfano, 34 F. Supp. 2d 827 (E.D.N.Y. 1999). Thus, unless some provision of the Bankruptcy Code provides otherwise, the Service's tax lien against the debtors' interests in the retirement plans survives the Chapter 13 discharge under the general rule. However, pursuant to the Bankruptcy Code provisions discussed above, "lien stripping" may be permitted under Chapter 13. Therefore, to determine whether the Service's lien in the present case survived as against the retirement plans, it must be determined whether the language of the above cited Bankruptcy Code provisions permits "lien stripping" of non-estate property.

We first note that section 506(a), which generally permits the bifurcation of a creditor's undersecured claim into a secured portion and an unsecured portion, expressly refers to "[a]n allowed claim of a creditor secured by a lien on property *in which the estate has an interest*." (Emphasis added). Clearly, this section does not permit bifurcation of a creditor's interest in property never part of the bankruptcy estate. Also, even assuming that, in the context of a Chapter 13 proceeding, "allowed secured claim" in section 506(d) has the same meaning as the bifurcated secured claim in section 506(a) and thus may be used in Chapter 13 to strip a lien of an undersecured creditor, it would only strip a lien against property "in which the estate has an interest" and would not affect the Service's lien here on the non-estate property.

Thus, even if lien stripping is permitted against undersecured creditors by section 506, any such lien stripping applies only to property of the estate or property in which the estate has an interest. This principle is made clear by a consideration of Chapter 7 cases decided prior to the Supreme Court's decision in Dewsnup that considered whether a lien could be stripped from abandoned property or exempt property. Some courts held that the estate had a sufficient interest in such property to justify lien stripping. See, e.g., Gaglia v. First Fed. Sav. & Loan Ass'n, 889 F.2d 1304 (3rd Cir. 1989). Other cases held to the contrary because the Chapter 7 trustee does not administer abandoned or exempted property. See, e.g., Dewsnup v. Timm (In re Dewsnup), 908 F.2d 588 (10th Cir. 1990), *aff'd*, 502 U.S. 410 (1992) (lien stripping not allowed on abandoned property) and Doty v. Sec. Trust & Sav. Bank (In re Doty), 104 B.R. 133, 136 (Bankr. S.D. Iowa 1989) (estate has no interest in exempt property). Unlike these cases, the present case involves property that was never property of the estate. Even if abandoned or exempt property may be viewed as property in which the

estate has an interest sufficient to permit lien stripping, the same cannot be said of the debtors' interests in the retirement plans, which were never property of the estate.

Our conclusion that the tax lien against the non-estate property in the present case survived the Chapter 13 bankruptcy proceeding is also supported by the language of section 1327. This section deals with the effect the confirmation of a plan has on "all of the property of the estate," which in the present case does not include the debtors' interests in the retirement plans. Thus, section 1327(c), which, upon confirmation of the debtors' plan vested all the property of the estate in the debtors "free and clear of any claim or interest of any creditor provided for by the plan," did not affect the Service's tax lien against the debtors' interests in the retirement plans.

The following cases lend further support to our position that, with respect to non-estate property, a federal tax lien survives a Chapter 13 plan if the tax liability is not fully satisfied by the plan. First, United States v. Alfano, 34 F. Supp. 2d 827 (E.D.N.Y. 1999) provides support for our position. This case involved the government's suit to foreclose a federal tax lien on real property that the defendants' parents had transferred to defendants several years prior to the litigation. The transfer may have been a fraudulent conveyance. Id. at 842. The Service claimed a tax lien against the property arising from tax liabilities incurred by the parents prior to transferring the real property to the defendants (although not assessed until after the property transfer). See id. at 830-831. The Service asserted this tax lien even though the parents had previously filed a Chapter 13 petition and had been discharged "from 'all debts provided for by the plan.'" Id. at 831. In the parent's Chapter 13 proceeding, the Service filed a proof of claim consisting of a secured claim which the Service ultimately agreed to reduce to $2,000, with the remainder of the claim classified as unsecured. See id. at 831. Also, although the facts are not entirely clear, it appears that the Service's claim was provided for by the Chapter 13 plan. See id. at 831, 842. While the court discussed several issues, it ultimately held that the tax lien against the real property had survived the earlier discharge of the parent's liability. See id. at 843.

In reaching this conclusion the court recognized the "body of caselaw standing for the general proposition that a debtor is entitled to a release of a lien after paying off the secured portion of a creditor's claim pursuant to a reorganization plan." Id. at 842. Nevertheless, the court reasoned that

> the case at bar is not a characteristic "lien-stripping" case in which the value of the collateralized property is determined at the bankruptcy proceeding and the lien is stripped as the debtor pays the value of the collateral securing the undersecured creditor's claim and the lien is released. The property at issue was never before the bankruptcy court.

Id. at 843. This case illustrates the principle that after discharge a federal tax lien may remain on property never before the bankruptcy court and not property of the estate

notwithstanding the fact that the Service filed a secured claim in the Chapter 13 proceeding that was seemingly provided for by the plan. Similarly, the tax lien should survive in the present case as the property at issue was never property of the bankruptcy estate.

In re Fink, 153 B.R. 883 (Bankr. D. Neb. 1993) also lends support to our position. In this Chapter 13 bankruptcy case, the Service filed a proof of claim that included the value of the debtor's retirement annuities in its secured claim. The debtor objected to the proof of claim. The primary issue in the case was whether the debtor's retirement annuity was part of the Chapter 13 bankruptcy estate. See id. at 884. The court agreed with the debtor that the annuity funds were not property of the bankruptcy estate pursuant to B.C. section 541(c)(2) and determined that the Service's allowed secured claim would be determined without including the value of the retirement annuities. See id. at 886. However, the court deemed it appropriate to note that "from the Debtor's standpoint, it arguably makes little difference whether the [retirement annuity] is or is not property of the bankruptcy estate. In either case, the Internal Revenue Service's claim will be secured by the annuity. This, of course, makes the court wonder why this litigation was pursued by the Debtor." Id. This language seems to imply that in the court's view, the tax lien against the retirement annuities would survive the bankruptcy even though the Service filed a proof of claim.

Moreover, in Vermande v. United States, Internal Revenue Service (In re Vermande), 1994 Bankr. Lexis 1430 (Bankr. N.D. Ind. 1994), the court dismissed a debtor's action seeking to avoid the Service's tax liens against the debtor's interest in a retirement fund. The debtor argued, in part, that the Service's lien against the retirement fund was void pursuant to B.C. section 506(d) because, according to the debtor, the retirement fund was not part of the bankruptcy estate and the Service therefore had "no allowed secured claim against the fund." Id. at 12. While the court agreed that the debtor's interest in the retirement fund was not property of the estate, it held, in part, that "the debtor's complaint fails to establish sufficient facts to void the IRS's tax lien against the debtor's rights in the [retirement fund] under § 506(d) because the section does not apply to liens on property in which the estate has no interest." Id. at 13. We believe these cases support our view that a tax lien against non-estate property survives a Chapter 13 bankruptcy discharge even where the Service has filed a secured claim that is provided for by the plan.

3. Litigation Hazards and Other Concerns

As noted by the court in United States v. Alfano above, we acknowledge there is authority holding generally that when a secured claim is provided for by the reorganization plan, the lien securing the creditor's claim should be cancelled. See 8 Collier on Bankruptcy ¶ 1300.73[4] at 1300-153 (Lawrence P. King, ed., 15th ed. 2002); see also In re Johnson, 213 B.R. 552, 556 (Bankr. N.D. Ill. 1997). According to Collier,

> [i]f the allowed secured claim is satisfied under the chapter 13 plan, the lien securing it should be canceled. Hence, at the end of a completed chapter 13 plan, the holder of such a claim will have no rights remaining against the debtor or property of the debtor; any unsecured portion of claim will have been discharged under section 1328(a).

8 Collier on Bankruptcy ¶ 1300.73[4] at 1300-153 (Lawrence P. King, ed., 15th ed. 2002). Based on this line of authority, it could be asserted in the present case that because the Service filed a proof of claim and its secured claim was satisfied under the Chapter 13 plan, the Service's tax lien, including its lien against the retirement plans, should be released. Nevertheless, we believe this line of authority is properly interpreted as requiring a creditor whose secured claim has been provided for by the Chapter 13 plan to release the lien only with respect to the debtor's property that was property of the bankruptcy estate and would not require the creditor to release the lien with respect to non-estate property. Thus, we believe that the proper interpretation of this authority would not contradict our position in the present case that the Service's tax lien against the debtors' interests in the retirement plans survived bankruptcy.

We further recognize that pursuant to B.C. § 1327(a), "[t]he provisions of a confirmed plan bind the debtor and each creditor, whether or not the claim of such creditor is provided for by the plan . . . ." As one court stated, "a confirmed plan is res judicata as to any issues resolved or subject to resolution at the confirmation hearing. Among these issues is the amount of a secured claim." In re Demarco, 258 B.R. 30 (Bankr. M.D. Fla. 2000) (quoting In re Meeks, 237 B.R. 856, 858-859 (Bankr. M.D. Fla. 1999)). In the present case, the Service had a claim, secured by property of the bankruptcy estate, of approximately $Dollar Amount 1. This secured claim did not include the value of the debtors' interests in the retirement plans.[2] The Service's position that the tax lien against the non-estate property survived the debtors' bankruptcy does not challenge the binding effect of the Chapter 13 plan or dispute the amount of the bankruptcy secured claim. Simply stated, the extent of the Service's interest in the debtors' interests in the retirement plans was not "subject to resolution" in the present case. As previously mentioned, the court in the present case determined that the retirement plans were not property of the estate and that it lacked jurisdiction to determine the Service's interest in the non-estate property. Thus, the debtors' interests in the retirement plans were never property of the estate subject to the terms of the Chapter 13 plan. Therefore, in our view, the confirmed Chapter 13 plan in the present

---

[2]As noted earlier, although it is currently the Service's position, pursuant to In re Lyons, 148 B.R. 88 (Bankr. D.D.C. 1992), that the value of a debtor's interests in such retirement plans is estate property with respect to the Service and thus may be included by the Service in calculating its secured claim in the bankruptcy proceeding, this was not the position of the Service at the time of the proceeding in the present case.

case has no res judicata effect on the Service's claim against the debtors' interests in the non-estate retirement plans.

In summary, based upon the language of the relevant provisions of the Bankruptcy Code discussed above along with the supporting caselaw cited herein, we believe that notwithstanding a discharge of the underlying tax liabilities, a federal tax lien does survive a Chapter 13 bankruptcy with respect to property not part of the bankruptcy estate. Thus, it is our view in the present case that even though the Service's secured claim was provided for by the plan and the underlying tax liabilities were discharged, the Service's tax lien against the debtors' interests in the retirement plans was not stripped.

If you have any questions, please contact the attorney assigned to this case at (202) 622-3620.